RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Aug. 19, 1992 **LETTER 1102**

"STOCKS COLLAPSE; DOW HITS RECORD HIGH!" Could this headline appear? Actually, we haven't been far from it. It's been an extraordinary year on Wall Street. Most portfolios are down for the year, most mutual funds are down for the year, 40% of all stocks are down substantially for the year. The Dow itself has been the star performer, but even here, 40% of the Dow's 1992 rise has been the result of the action of one single stock -- Disney.

Does all this make it a bear market? The answer is -- "No." If or when the Dow heads down in earnest, that's when we'll be in a primary bear market. Until then, what we have is an expensive, messy, frustrating market.

Wait, let me put it another way. We could be in the early stages of a primary bear market, but we can't prove it at this time. When could we prove it? When the Averages render a bear signal under Dow Theory. How could that happen? It could happen if the Dow breaks below **3181.35,** an action which would confirm the already weak action of the Transportation Average (the Transports have already given half of a bear signal).

Once again, I'll repeat that in this business the trend is assumed to remain in force until proved otherwise. As this is written, we have no proof of a change. Thus, we can be suspicious, we can dislike the market, we can worry about overvaluation, but according to Dow Theory, "It's a bull market until proved otherwise."

BULLING THE MARKET: What's the rationale for a market that has been rising or hanging on in the face of overvaluation, lackluster business, high unemployment, high level of bankruptcies, low almost non-existent growth in the money supply and nation-wide discontent and pessimism?

I've said this many times, but I'll repeat it. Basically this market has been trading off the decline in interest rates. Rightly or wrongly the market's reasoning runs this way -- somewhere ahead today's extremely low interest rates "should catch on," at which point the economy should turn decisively up. Today's low interest rates mean that the nation can refinance all its bad debt. Today's low rates mean that mortgages are now at bargain levels. Today's low interest rates make it cheaper for businesses to borrow and expand. Finally, today's low interest rates (it is hoped) will re-inflate a sluggish and deflationary economy. With the current massive amount of debt choking the nation, the only way out (at least according to the Administration and the Fed) is through a process of re-inflation.

And of course a trend to lower interest rates increases the value of stock dividends and the value of stocks themselves. For instance, if T-bill rates are 8% and average stock dividends are 3%, it's hardly attractive to put money into stocks. But if T-bill rates are 3.19% (which they are now) and stock dividends are 3% (about where they are now) then stocks become increasingly attractive.

One caveat -- all the above applies to stocks and fixed-income instruments during a primary bull market. BUT, if stocks are in a primary bear trend, then I don't care how low the Fed manipulates interest rates, stocks are going to be heading south.

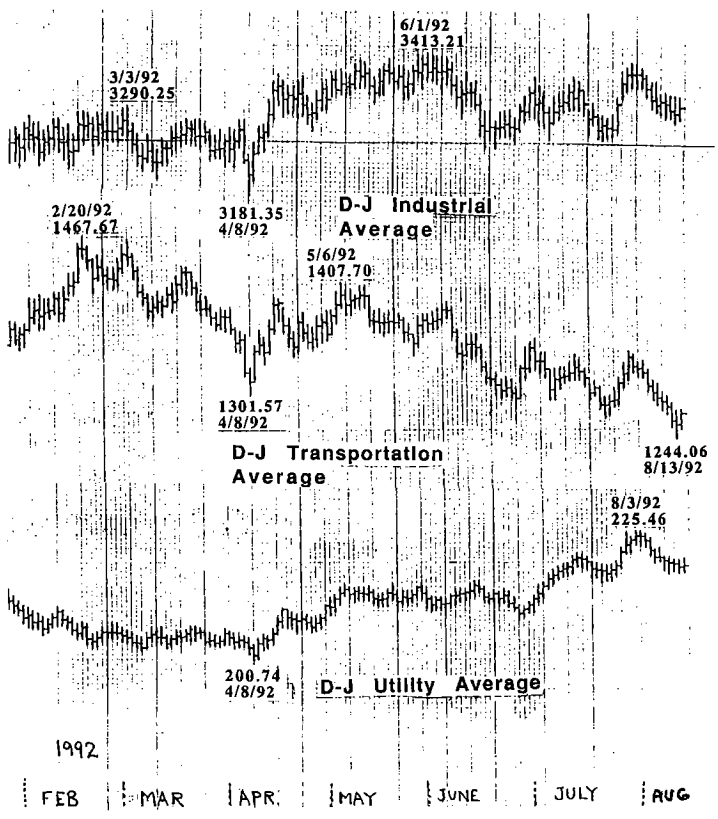
Everyone knows the lessons of the 1930s, a time when the nation was in the grip of a mighty bear market. Interest rates were lowered to the point where banks were paying 1.5% interest and T-bills were paying around half a percent. But during the '30s they could have taken rates to zero and it wouldn't have helped the stock market. The nation was in the grip of paralyzing fear, and that fear had to run its course.

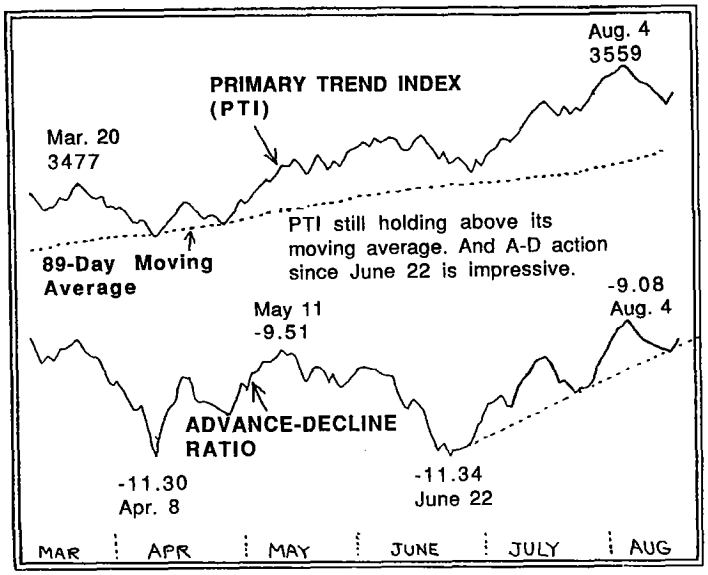
Aug. 7 DJIA 3332.18; PTI 3547; A-D Ratio -9.39
Aug. 14 DJIA 3328.92; PTI 3541; A-D Ratio -9.38
Dow Yield: 3.11%; Dow Price/Earnings: 57.7
Dow 200-day MA: 3232; Dow 30-day MA: 3345
Dow Times Book Value: 2.55; PTI 89-day MA: 3500
Percentage of Undervalued Blue-chips: 9%

People don't realize how awful that primary bear market was. During the early 1930s international trade dropped 60%, GNP in the US dropped 50%, one third of the nation was unemployed. It was a true economic horror show, and the extremely low level of interest rates failed to turn the tide.

On page 2, I include Ned Davis' chart (*Ned Davis Research*) of the S&P 500 and the yield on the 91-day T-bill. It's interesting to see the inter-play between the S&P and the T-bill yield. Note that from the 9.03% yield of 1989, T-bill yields dropped steadily until the 3.19% yield of today. This represents a huge percentage drop, and it is this phenomenon that the stock market has responded to.

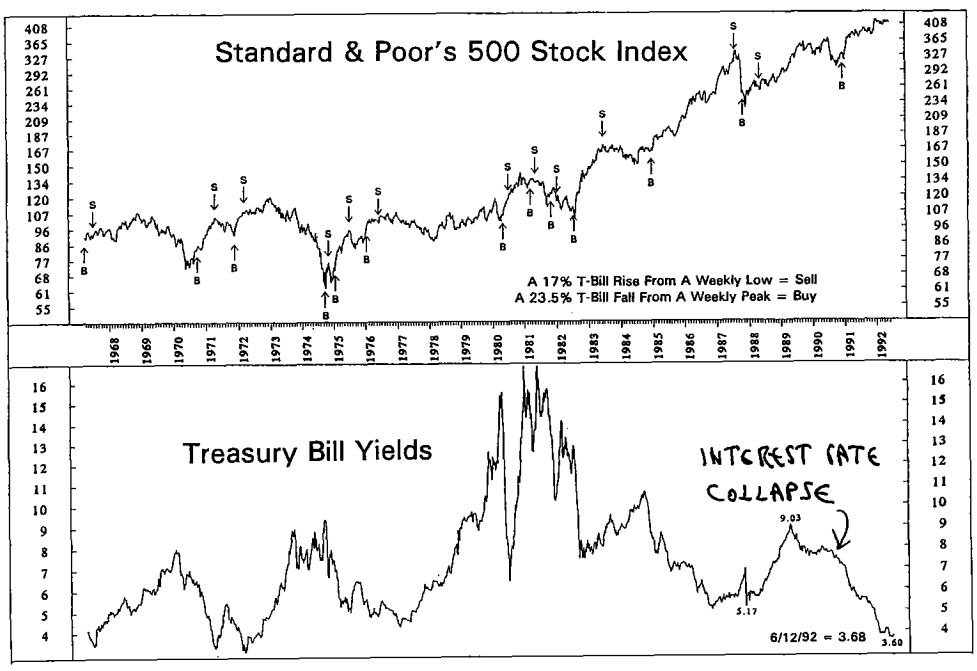
The Fed has reduced interest rates 23 times (seven discount cuts alone) over the past two years. And so far, the economy has not turned around. So here's the question I ask myself (in secret, of course) -- is this a "covered up" 1930s situation, or is this just a particularly difficult juncture in a continuing bull market? And unfortunately, it's a question I can't answer with certainty at this time.





INTERNATIONAL PICTURE: Today we're seeing a phenomenon that's unique to anyone born after World War II. It's called world deflation. Last week the Japanese stock market broke to a six-year low, the British stock market broke to an 18-month low, the German market broke to a low for the year, the CRB Commodities Index sank to within a hair of a six-year low, and gold dropped into the 330s. The deflationary fact is that almost all the stock markets and economies of the free world (with the exception of the south Asian countries) are heading down. Real estate prices from France to Britain, from Japan to the US are declining. Prices of goods at the retail level are being squeezed, and the word is, "Unless it's discounted, it won't sell."

But there's an irony. The ex-Soviet nations, East Germany, the nations of Asia, they were all supposed to be areas of massive new demand. We were supposed to sell these "new areas" ship-loads of our free enterprise goods. Instead, these nations are turning out to be areas of supply. In Vietnam laborers earning less than $1 a day are turning out a torrent of goods. In China the same thing is happening. In Hong Kong and Taiwan and South Korea it's the same thing. All this is militating towards world deflation. From computers to toys, from autos to TVs, the word is vicious international competition and competitive pricing. And the key to surviving in the "new world" will be productivity. Remember that word -- PRODUCTIVITY (which means turning out products as cheaply and as efficiently as possible).


Standard & Poor's 500 Stock Index
A 17% T-Bill Rise From A Weekly Low = Sell
A 23.5% T-Bill Fall From A Weekly Peak = Buy
Treasury Bill Yields
INTEREST RATE COLLAPSE
9.03
5.17
6/12/92 = 3.68
3.60

Comment: It's easy to halt inflation, you just raise interest rates and put any economy into "the big squeeze." Deflation is another matter. Deflation tends to take on a life of its own. The US has brought interest rates down to the floor, and all that's done is bull the stock and bond markets and killed the dollar. But has it halted deflation? Time will tell.

MARKET ACTION: All right, now let's forget the forecasts, the scenarios and the crystal balls and deal with what's actually happening. First, it's important to know what has not happened. We have not received a Dow Theory bear signal, and in the absence of such a signal, we will assume that the primary bull trend is still in force.

Second, we have seen recent new highs in the NYSE Composite and the S&P 500. That's bull market action. Third, we have seen recent new highs in my persistently bullish Primary Trend Index. Fourth, the advance-decline ratio has bettered its downtrend, and it has also bettered its preceding peak.

So why not be loaded with common stocks at this time? The argument against that position is that based on yields (the return on the investment), stocks are extremely overvalued here. The very basis of Dow Theory is that stocks are a buy when they represent great values, and stocks are a sale when they rise to the point where they are extremely overvalued. The time-honored test of values is yield, the return on investment.

The yield on the Dow is currently 3.12%. That 3.12% yield is based on total Dow dividends of $104.07. Behind the $104.07 in dividends we have trailing Dow earnings of a measly $56.78. In other words, dividends on the Dow are almost twice cumulative earnings (cumulative earnings include deficits in certain Dow stocks). Earnings on the Dow are supposed to rise dramatically in coming months. They had better! Nevertheless, the current dividend yield for the D-J Industrials is low, and worse -- dividends are only half covered by earnings.

Conclusion: The stock market has been trading off declining interest rates. One thing is sure -- this market isn't trading off of stock values. Based on the return on investment, the values aren't there.

THE BATTLE: I've stated repeatedly that this nation's problems can be summed up in three words, "Inflate or die." That's never been truer than it is today. For the last three years the policy of the Administration and the Fed has been to battle the forces of deflation -- deflationary forces brought on by the unwinding of the massive leveraging which took place during the 1970s and '80s.

Overseas, the Germans have their own battle to fight. The German authorities miscalculated on the costs of reviving East Germany. As a result, they had to pour billions of marks into East Germany. Today both the money supply and the inflation rate in Germany are well above what they feel comfortable with. Consequently, the Germans have raised their interest rates with short rates now in the 9.75% area (most European rates are inverted). Since the European nations have agreed to keep their own currencies within the German currency band, this means that Europe is now in the grip of high interest rates. This is occurring despite the fact that Europe is in recession.

The immediate impact on the US is two-fold: (1) The huge interest rate advantage in favor of European debt has meant that the European currencies have rallied strongly against the dollar. Since the first of the year the dollar has dropped roughly 16% against an average of European currencies. (2) Ordinarily a "bargain-priced" dollar would boost US exports

because of the competitive advantage of cheaper US goods. But ironically, because Europe is in recession, US exports have declined for four months running. Exports, by the way, have been responsible for most of the US' growth over the last few years.

The authoritative *Bank Credit Analyst* (August) has some interesting words to say about the current situation: *"The US is in uncharted waters. There has never been an orderly working-off of debt overhang within the context of a slow-growth environment. In the not so distant past, debt overhangs have been worked off with massive debt defaults in the context of economic depressions. No government would tolerate a repeat of that experience, given widespread support in the post-war period for the revolutionary role of the government as a last-resort borrower, lender employers, and provider of safety nets.*

"It is clear that the world of the 1990s is much closer to the 1930s than any other subsequent period. The world is very deflationary and the trend does not seem to be easily reversed. Policy in most countries remains deflationary in spite of very tough economic conditions for some years."

It's obvious that the US is fighting the deflationary trend tooth and nail. But so far it's been the Fed's fight, and the battle has revolved around a lowering of interest rates to the point where rates are now at their lowest level in almost 30 years. However, this is also the first recession since WWII in which the government has been unable to fight the trend with increased spending. The reason is obvious -- the government is fearful of pushing the current $450 billion deficit even further out into fiscal space.

So far, the loser in the US government's battle against deflation and recession has been the dollar. At this point the various central banks have been intervening in an effort to slow the dollar's decline. Best bet is that the intervention may continue until around election time (after all, a panic-collapse in the dollar would embarrass the administration).

But in my opinion, the Administration would be perfectly willing to see the dollar go to new all-time lows against the European currencies. The only requirement would be that the dollar decline in an orderly fashion. Along these lines, it would not shock me to see the Fed lower the discount rate once again prior to the election, particularly if there is no appreciable pick-up in the economy.

JAPAN: The Japanese market is now at its lowest level since 1986. The Nikkei Average has, so far, lost 62% of its value. Unfortunately, my subscribers can't see charts of individual Japanese stocks, but I receive *International Chart Analysis* (7 Swallow St., London W1R 7HD), and they chart almost 200 Japanese issues. The collapses in these stocks has been shocking, with many (actually most) issues down 50% to 80%. The losses to Japanese investors have been frightful.

These losses have been severely impacting the Japanese economy, and I believe the pain will increase as the losses spread further and further though the economy. Already, the bear market in Japan is hurting US exports. In Alaska, for instance, which is a big importer to Japan (fish, raw materials), the drop in exports has been dramatic.

In West Germany (the only nation in Europe not in recession) industrial orders for June fell for the fourth straight month. In France unemployment has hit a record high. The stock markets of Europe are in disarray. And the big question in my mind is whether Europe is on its way to following Japan. If so, the pressure on central banks around the world to cut interest rates, to re-inflate, will be intense. And that, by the way, is the rationale for owning gold and gold items -- and European bonds.

THE DOLLAR: The administration, the Fed and the Treasury are following a policy that has to be called dollar devaluation. By this time almost everyone has seen a long-term chart showing the dollar's collapse. If you've seen the chart, YOU KNOW.

As an American my attitude regarding the sinking dollar is one of disgust. The time-honored view is that the path of a nation's currency is a barometer of a nation's strength and of its productivity. But more than that, the dollar is the world's reserve currency. As such, the dollar should be a store of value. But the dollar has been anything but a store of value. What it's really been is a guaranteed vehicle of loss. If you're an American with a knowledge of economic history, what's happening to our currency now should fill you with mixed feelings of tragedy and disgrace.

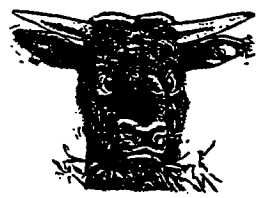
Over recent weeks we've seen central bank intervention by 14 central banks in an effort to stem the tide. But intervention never reverses the trend, it simply holds it back. My feeling is that the dollar "wants" to go down, probably to new record lows against the D-mark. With gold down and with "no inflation" in the US, it seems to me that the Fed and the administration are now ready to let the dollar sink to its own level against the hard currencies.

As I see it, there are two great battles taking place in the world markets today. The first is the battle of the "still hanging-on" US stock market vs. the primary bear market in Japan. Will The US join Japan's bear trend or will it resist it? My guess -- we'll join Japan, in due time.

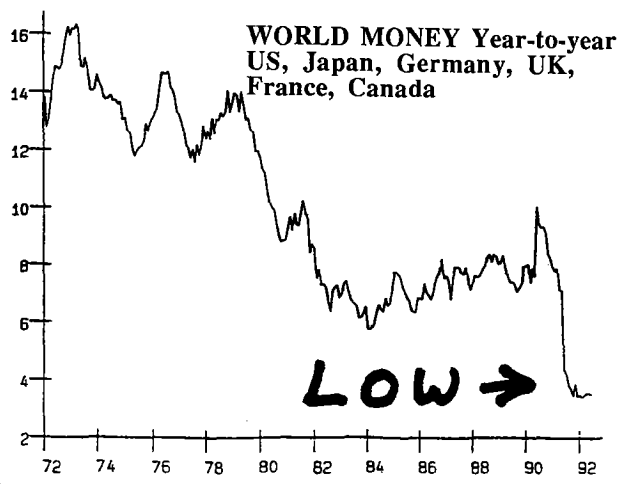
The second great battle is the dollar vs. the D-mark. Will the US' desire to re-inflate (while sacrificing the dollar) win out against the Bundesbank's stubborn stand against inflation? My guess -- the Bundesbank (the world's most independent and least political central bank) will win, and the weak dollar will give way to the powerful mark.

Two critical and fascinating battles, and two battles which the man on the street is totally oblivious of.

INVESTMENT POSITION: My old friend, Joe Granville, states flatly that we are in a bear market and have been in one since January. Joe uses a good deal of his own original indicators, and Joe can be very brilliant. I know Joe's work well, and I don't like to be on the wrong side of his analyses. But I just haven't received Dow Theory confirmation of a bear market. And although my PTI has violated its most recent rising trendline, a first bearish step (see page 2 chart), it's still above its moving average. So the bull stays in the box. He's sweating and nervous, but he's still a bull.



The economies of Europe are in recession or sliding into recession. This chart (courtesy of Ed Hyman and *ISI*) tells the story. World money supply is slumping, and the dominant force today is global disinflation or deflation. Even the mighty German economy is beginning to stumble. And, I wonder, how much longer will it be before European rates start coming down?



Where are the long rates now? Here are some examples of government rates on longer-term bonds: Australia 8.35%; Belgium 9.32%;France 8.37%; Germany 8.98%; Holland 8.43%; Italy 11.83%; Spain 12.81%; Sweden 10.22%; UK 10.19%; **USA 7.35%.**

I've been recommending the **Benham European Government Bond Fund** as an investment I like and an investment that I personally am in -- [(800) 321-8321]. I like this fund for three reasons. One: Short-term interest rates still favor the D-mark over the dollar by a matter of better than 6%. Most of the European currencies are fixed within the D-mark band, which means that they can only fluctuate within a few percentage points on either side of the mark.

Secondly, as the recession bites deeper into the European economies, I think there will be pressure to lower European long rates. Thus over the longer term I see a double plus in being out of dollars and in European government long bonds.

Third, the Benham fund is in government bonds only, so there is little if any chance of default, even in the event of a world depression (and if things get really bad, safety will become a prime consideration).

For those buying individual Euro-bonds, remember that most European rates are now inverted (short rates higher than long rates) and the highest rates are out about three or four years. So if you buy European debt, the highest yields should be around 1994-5, but the biggest play on declining Euro-rates would obviously be in longer-term bonds.

I've had many subscribers ask where or how to buy Euro-bonds. Easy, call your broker. If your broker can't help you, find a broker who knows what's going on. I happen to use Merrill Lynch for foreign bonds. Yesterday I got a call from a nice lady in San Francisco who complained that her Merrill Lynch broker said that Merrill didn't handle foreign bonds. I suggested that she change brokers. After all, I told her, investing is difficult enough without dealing with a guy who doesn't know what's happening in his own firm.

NOTES & QUOTES: I want to start by thanking subscribers for all the letters, comments, clippings and books sent to me. I try to answer some of the letters, but either the times are changing or my personality is changing because I'm getting more letters now than ever before. Furthermore, people are sending me pamphlets, books and video tapes. I read ALL the letters, I answer some, I look at the videos and I'll read a book if I think I'll learn something from it. But the point is this -- if you write and I don't answer please don't be insulted. It takes a lot of energy and time to answer a letter intelligently. If you've written a letter and you don't hear from me, it just means that I've run out of juice. I appreciate all the letters and the articles and clippings, believe me, but I have to conserve my energy for the Letters. So again, thanks to all you correspondents, even if the correspondence is only one-way .

* *

Every year or every era seems to produce a favorite new investment gimmick for Wall Street. Last year's favorites were the money supply numbers, the famous M-1, M-2 and M-3s. The current favorites are the government's monthly unemployment statistics. If unemployment is down and employment (particularly factory employment) is up, that's good for the nation and for stocks and for the dollar. But it's bad for fixed-income instruments, because a rising economy usually means higher interest rates, and those in turn give way to falling prices for bonds, notes and bills.

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The Senate is eager to cut the military. Listen to these statements for a hint as to the future. From Sen. Paul Simon (D., Illinois): "There is no Soviet Union anymore, but the winds of change have hardly touched the US defense budget." And this from Sen. Moynihan (D., NY): "We're still totally organized to fight the Cold War," and we're "looking around for other wars" to justify spending. Russell opinion: Watch for massive military cuts as the deficits continue to pile up and as the recession lingers on. Bush has been using the defense budget as a "make work" vehicle, and he's been pushing arms sales as a "make exports" vehicle. I don't think that's going to work much longer, George.

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The *Sindlinger* organization reports (I got this by FAX, August 7) that "the decline in our Current Income Index continues to shatter old records . . . An unprecedented 67.9% of the surveyed household heads or 109 million households indicated that income was down from six months before. Such measures are the greatest negative extreme ever seen in Sindlinger's 38 years of continuous daily household surveys." Russell comment: You wonder why people aren't buying and borrowing? Easy answer -- they don't have the money.

* *

Bye, bye, Golden State: My wife, Faye, told me that one of the lawyers in her firm is moving out of California. Only trouble is that he can't find a moving company who can take the work (seriously). Yep, the busiest guys in California are the fellows with big biceps who know how to lift furniture and pack it in a moving van -- the moving companies are completely booked up. Mull that over, Governor Wilson and all you tax-and-spend politicians in Sacramento who have wrecked the finances of this state.

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A few weeks ago Robert M. Miller, a prominent bankruptcy lawyer, threw his annual bankruptcy party ("The Creditor's Ball") at Westhampton, Long Island, New York. As usual, the party was attended by bankruptcy lawyers from all over the nation. Problems were discussed and one problem was that many of the leveraged buyouts of the 1980s have already gone through the wringer. Business is slow in that area. Not to worry. William Jacobs, a director in the high-yield group at First Boston Corp. noted, "Real estate is going to be big. There's $260 billion of commercial real estate debt maturing between March 1992 and June 1993, and nobody's lending money anymore." Russell comment: Now that's a thought, isn't it?

* *

One successful method of investing is always to be in the five or 10 highest-yielding Dow Industrial Stocks. Each six months you adjust to be in the new high yielders. Here's the latest list -- Union Carbide 6.00%; Sears 5.06%; Texaco 5.05%; IBM 4.88%; Chevron 4.74%; Exxon 4.69%; Kodak 4.68%; Westinghouse 4.20%; Woolworth 4.19%; American Express 4.12% (Statistics courtesy of *Amer. Investment Services,* Inc., Great Barrington, MA 01230).

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One of the pleasures of living in La Jolla is that you can take a 10 minute ride up to the campus of UCSD and watch the San Diego Chargers football team work out. Who was it that said, "I love work, I could watch it for hours"? That's the way I feel as I watch these guys working their heads off (half of the 99 men will be released before the season, so these fellows don't fool around -- they work hard). But for us lookers, it's pleasant, exciting -- and free. Just another bonus for living in the crazy, bankrupt state of California. By the way, I just read in *Penthouse* (of all places) that "a recent study reveals that football players have a life expectancy of only 55 years", which is 16 years less than the average American male. The National Institute for Occupational Safety and Health is now conducting a study to try to find out why these professional athletes die so young. My guess -- too many body blows, and in many cases too much weight.

* *

China: Economic reforms may be rubbing off on the Chinese censors (and I think this is very significant). "Raise the Red Lantern" and "Qui Ju's Lawsuit," two very controversial films, have been approved and are now being shown. Observers state that this is the clearest proof that we are now seeing a loosening of cultural control in China. Meanwhile, the old Chinese guard (mostly in their 70s and 80s) are dying off, and it is almost certain that their more liberal children will be the new leaders of China.

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INC magazine ran a feature article in their August issue, "The Best Places in America to Own a Business." After sifting through all kinds and varieties of cities, the winner turned out to be the Research Triangle Park in the Raleigh-Durham area of North Carolina. Other finalists were Washington DC, Kansas City, Salt Lake City and Cleveland.

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The more I hear and read about Clinton's "plans" for America, the more uncomfortable I feel. This from Thomas Sowell's column in the August 17 *Forbes*: "Governor Clinton's economic policy has all the proven ingredients of disaster -- more taxes, more spending and more hidden costs imposed on the economy through programs mandated for business."

As for Al Gore, he's the only Senator ever designated as "the biggest spender" two years in a row. When it came to spending bills, Gore voted for practically everything. Last year he even voted against eliminating honey price supports, one of the few spending cuts in Clinton's economic plans.

* *

We just bought a Toshiba 4400 SX "notebook" which is a powerful little IBM compatible computer (we also use Macs). I suddenly got curious about how it all started, so I bought the new biography of Bill Gates, the co-founder of mighty Microsoft. Gates was a "computer-nerd" from his early teens and started as a programer. Presently, Gates is considered the richest American (he's still in his mid-30s), and he's also considered a devil to work for (he's notorious for his bad temper and for shouting at his cowering employees). As an interesting aside, John D. Rockefeller at his peak was worth four times the $7 billion that Gates is worth, and there were no income taxes in John. D's time. As for the Gates book, read it, it's fascinating.

* *

The banks are at it again -- making big loans to South American countries. But this time it's different. The banks aren't using their own money. It's a process that began in a trickle in 1989, but it has now reached very large proportions. The way it works is that the banks bring long, medium and short-term debt issues to the market on behalf of the issuers and the nations involved. How credit-worthy are the S. American countries? No one knows for sure, but optimism is currently running high. As I said, there's a big difference between the loans of the 1970s and '80s, and the loans of the '90s. This time if the loans go bad, it will be the customers, not the banks, who will be stuck with junk paper.

* *

The following is from a recent speech given by noted author Michael Crichton in front of the Japan America Society of Southern California: *"Now that 'Rising Sun' is off the best seller list and the hysteria surrounding the novel has faded, it's worth noting that the issue at the center of it --America's long-term economic troubles -- continues to be ignored. The only candidates to address our long-term economic troubles, Ross Perot and Paul Tsongas, are gone. Neither George Bush nor Bill Clinton seem willing to talk about anything except near-term palliative steps. Meanwhile, America's strategic long-term problems are growing rapidly worse.*

"A decade ago this country was the world's leader in every major technological area and had the world's highest gross national product per capita. Today, we have lost the lead in most technologies and are falling behind in the rest. In no area have we gained ground. We now rank fifth in GNP per capita. Real wages have slipped to the 1960s level. And our national debt had tripled, creating burden that threatens our economic recovery.

"Are we, as a nation, to be rich or poor? Are we going to increase our productivity or sink into further decline? If we are to reverse the trends of three decades, what steps must we take?" Russell Comment: I wish I could include the whole speech. But Crichton's warning is valid. Neither presidential candidate is addressing America's pressing long-term problems. All they talk about is coming out of this recession (and Bush, of course, is saying that we are already out of the recession). Dream, wishes, double-speak, lies.

* *

Boola-boola: Our next president will be a Yale graduate. Bush is a Yale undergraduate (class of '48) and Clinton went to Yale law school (class of '73). If Clinton wins, the "Great Curse of the Yalie President" may repeat. Neither William Howard Taft (Yale 1878) nor Gerald Ford (Yale law school '41) were able to win a second term. My bet, Bush will lose in '92 and Clinton will lose in '96. Why? I think the Bush-Clinton fight will be close, but Bush just can't seem to do anything right, and the American people know it (I also think Bush's abortion stand will kill him). I'm betting that the US economy will turn out to be a nightmare for Clinton. And presidents with nightmare-economies never win second terms.

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Cutting spending (especially entitlements) is the one area every politician avoids like the plague. Listen to this from famed economist Milton Friedman: "You have this enormous bureaucracy in Washington, and also in every city and state, all dependent upon the continuation of New Deal and Great Society kinds of programs. Instead of Lincoln's government of the people by the people, we have government of the people, by the bureaucrats, for the bureaucrats -- including among the bureaucrats the elected bureaucrats. If you're going to have term limits, they ought to apply to the bureaucrats as well as to elected officials."

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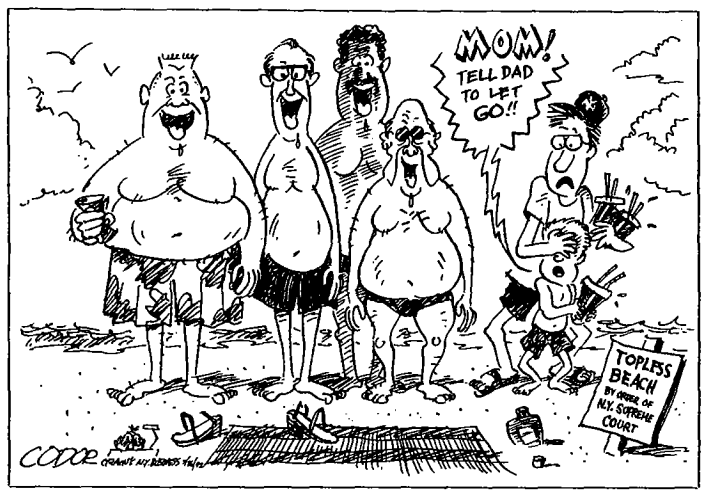
Check these figures: in 1980 the federal deficit was $72.2 billion and all personal income taxes collected by the government were $244 billion. That means that deficits equalled 29.8% of total personal income taxes. In 1992 the estimated deficit will be $449 billion while total personal taxes collected will be $478.7 billion. This means that the deficit will equal 93.8% of the personal federal income taxes collected. In other words, the deficit is now equal to almost all the taxes collected from all the nation's individual tax payers. As I've been saying, the deficits are now eating the US up alive.

* *

I'm amazed -- New York legalized toplessness for women before California did. Yep, New York women claimed before the Supreme Court that if men didn't have to wear anything on top, they shouldn't have to either. And the Court agreed. Much of Europe went this route years ago. In America, violence is accepted but the human body is out of bounds. At least one American cartoonist sees the terrible danger in this new New York development.



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This is the hundredth anniversary of the famed Lizzie Borden case -- Remember, Lizzie supposedly axed to death her mother (actually it was her step-mother) and her father. I was listening to an expert on the case, and he was asked why this particular case is so famous. He explained that the case involved a woman killing her parents, and 100 years ago it was considered inconceivable that a woman would be capable of committing such a brutal crime. "Of course," he said, "that kind of crime would be considered no big deal today."

WHAT'S REALLY HAPPENING: Often I'll step back and try to get the BIG PICTURE straight in my mind. Frankly, it's the big picture, the tidal sweep of events, that fascinates me. At any rate, here's what I see.

During the 1970s and '80s the US went on a massive inflationary borrowing binge. The binge was financed by banks, S&Ls, CDs, stocks, bonds, foreign money, you name it. During that period the

prices of everything went up -- real estate, art, stocks, antiques, precious metals, land, just about everything. It was a fabulous speculative era based on credit, confidence and yes, greed.

The problem -- by the early '90s everybody was in hock, and suddenly it occurred to people that the fuel, inflation, was ending. Prices weren't going up any longer. What was the trigger that ended the inflation-credit spiral? If I had to guess I would say it was the collapse of the Japanese stock market. The Japanese were the "mad financiers" of the '80s. They were the speculative bankers to the world. They were the guys who paid outrageous prices for stocks, for art, for hotels, for land, for corporations.

When the Japanese stock market (which was yielding nothing) keeled over in late-1989, few people noticed. But this year, with the Nikkei down 62% from its high, something happened. The speculation-inflation syndrome snapped. This phenomenon came on top of a persistent recession in the US and a slowing down of economies across the globe (with the exception of south Asia).

Today we're in the midst (or maybe the beginning, we don't know yet) of a huge credit meltdown. As you survey the scene you realize that almost everybody is trying to keep up their sliding standard of living, everyone is trying to capture income, everyone is turning worried or conservative, and everyone realizes that "things have changed, that something's wrong."

What's changed is that inflation is "missing." Today the price of your house is standing still or sliding, your stocks aren't going up, you're getting a minuscule return on your fixed-income securities, and your next-door neighbor just got a pink slip and is looking for a job.

On top of that every corporation in the country is trying to hang onto profits or boost profits by cutting spending (for cutting spending, read eliminating employees). In the meantime, the finances of our spendthrift government are totally out-of-control, and the deficits are eating up billions of dollars that should be going into savings. America has become an entitlement society instead of a producing society.

So I label the new game in America -- <u>reality.</u> Slowly, reality is confronting Washington and most Americans. And I mean SLOWLY. While the US is faced with vicious competition from around the world, we finally realize that we're dropping behind in productivity, in technology, and in research and development. Certainly, we don't have the leads, the monopolies in industries, that we used to have.

The new realities that we're living with today include a credit meltdown, disinflation or actual deflation, an unsustainable level of debt, and what I believe may be a state of chronic unemployment. As I see it, the easy days are over. The rest of the world has grown up or is growing up, and the US is no longer king of the economic mountain.

I don't know how it will all work out. I don't know whether we'll have a long, drawn-out bear market lasting maybe another three to five years, or whether we can hold these levels (I'm talking about the stock market), or whether we're due for a "big daddy" wipe-out type bear market.

Personally (and I obviously can't prove it), I think the tidal forces are in the process of turning down. I think we're facing a credit "run-off," and I think that the longer the government fights it the longer it will take for the run-off to go to conclusion.

But the major problem, as I see it, is the one I've been warning about for years. It's the federal debt. I don't see any politician seriously attacking the problem. The problem has to do with massive entitlements and a huge, un-needed military budget. It also has to do with the steady, unrelenting power of compounding.

A huge debt can be handled in an inflationary environment in which the power of the debt is continually diluted by a debasing of the currency. But in a deflationary environment, debt becomes a killer. And that may be the deciding factor in economies for the future. If the US goes into real deflation (watch the bonds and gold and the CRB Commodity Futures Index), then the debts will strangle us. Fifteen trillion dollars in US debt (private and public) can't be "kept afloat" in a deflationary environment.

In my book the US must re-inflate. Right now we're in no-man's land with inflation ebbing, and just a hint of the specter of deflation (mostly in real estate). Can the government turn things around and re-inflate the economy? God knows they're trying, but as I write this I don't have the answer. Well, that's the BIG picture as I see it. The final words will be spelled out, not by me, but by the markets. Keep reading, dear readers, and I'll keep trying to figure it all out.

GOLD: Obviously I can't prove it, but that big whack which gold took on August 12 and thereafter made me very suspicious. Just before the big whack, the dollar had been extremely weak and gold had risen a full 10 bucks. Now if there's anything the Fed and Mr. Bush don't want to see, it's gold climbing while the dollar breaks to a new record low (and they sure don't want to see it to happen the week before the Republican Convention).

Prior to the gold cave-in, the Fed and central banks had intervened (buying dollars) in order to put a break on the dollar's fall. When this didn't help -- along came the big whack on gold. Manipulation? Who was selling? Was it "a deal" engineered by the Fed? Maybe, maybe not. But as I said, it sure made me suspicious.

The other thing that aroused my suspicions was that gold had formed such a perfect "rounding bottom" pattern. It's highly unusual to see a pattern like that, a pattern that had taken months to form -- suddenly torn apart. Gold stocks had broken out to the upside (Newmont, Amer. Barrick, Pegasus) and suddenly out of nowhere -- wham!

Well look -- either the primary trend of gold has turned up or it hasn't. If it hasn't, then gold would have headed down anyway. But if the primary trend has turned bullish, then the August smash will make the technical condition of gold that much stronger and the ultimate move will be that much higher.

The gold action is not only important to gold-holders, it is very important in judging what is going on in the economy. Remember, gold has been sliding right along with the dollar. Normally, a sinking dollar will send gold higher. What this action tells me is that people still retain enormous confidence (maybe misplaced confidence) in paper dollars, and in the face of the dollar collapse of the last year they still see no need to buy gold.

Of course, for international money the alternative to both gold and the dollar has been the D-mark. That's why some people say that there will be no gold bull market until gold rises against the D-mark and the major hard currencies. They could be right.

LATE NOTES: My bond model is based on daily advances and decline on NYSE Bonds. I run it on the McClellan and Summation Indices and on August 14 it finally turned bearish. Minor correction, major correction, top out of the bond bull market -- can't tell yet, but I'm watching.

Obviously, if bonds head down, interest rates will head up, and it will be interesting to see whether the "teflon" Dow will be able to stand up against higher rates (remember, declining rates were the main impetus behind the Dow's advance).

Keep your eye on the page 2 chart. That chart is telling the story. When these two indices turn bearish, the real losses will begin. So far, however, they remain bullish (even though the general market has been ragged).

NEXT MAILING: Sept. 2, 1992